Before The
Federal Communications Commission
Washington, D.C. 20554

In The Matter Of	)	
	)	
Simplification Of The Depreciation Prescription Process	)	CC Docket No. 92-296

COMMENTS OF THE NYNEX TELEPHONE COMPANIES

New York Telephone Company
and
New England Telephone and
Telegraph Company

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SUMMARY

The NYNEX Telephone Companies commend the Commission for offering various options to simplify and modernize the depreciation prescription process. Such simplification is necessary to match the depreciation process with the rapidly changing competitive and technological environments in which we now operate. Related goals in this proceeding should be flexibility, timeliness, predictability and consistency with respect to capital recovery.

The Commission's price cap carrier proposal (option D) is the most promising approach to attain the above objectives. It will substantially reduce paperwork burdens, allow the Telephone Companies the flexibility to respond to intensifying competition and market forces in a timely manner, and provide for a predictable and consistent recovery of investments. Option D will also be fully consistent with the FCC's responsibilities to prescribe depreciation and notify the states.

Should option D not be adopted, the NTCs would support the range of depreciation rates option (option B) with several revisions. Most importantly, the levels and widths of the ranges must properly reflect our competitive environment in a forward-looking manner. The basic factor range option (option A) would not provide for significant simplification, but might

be a third best alternative if appropriately modified. However, the depreciation schedule option (option C) is neither simple nor progressive, and should not be considered viable.

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I. INTRODUCTION

New England Telephone and Telegraph Company and New York Telephone Company (the NYNEX Telephone Companies or NTCs) submit these Comments in response to the Commission's Notice of Proposed Rulemaking (NPRM) released December 29, 1992, in the above-captioned matter. Commendably, the Commission invites comments on four options "to reduce unnecessary regulatory burdens and their associated costs by undertaking simplification of our depreciation prescription process."[1] As discussed below, to best meet its goals, the Commission should adopt a slightly modified version of its price cap carrier proposal (option D). The NTCs also fully join in and endorse USTA's Comments being filed today in this docket, which address further details of the items in the NPRM.

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1 NPRM para. 1.

II. DISCUSSION

A. Background And Goals Of This Proceeding

Under current FCC depreciation prescription procedures, the larger Telephone Companies under the Commission's jurisdiction must file, every three years, a detailed record of all plant additions, retirements, costs of removal and salvage. These records are filed by account (e.g., digital electronic switching systems [ESS], poles, aerial metallic cable, etc.), and are further detailed by vintage. For example, if $1 million worth of telephone poles were retired in a particular year, the filing must also separate that amount according to when the poles were initially placed. The filings are quite voluminous. In the New York Telephone 1992 Depreciation Rate Filing, the section on Analog ESS was 92 pages alone. The 1993 New England Telephone filing comprised five 3 inch binders totaling over 3200 pages of material. This is even with some simplification already having taken place. Small accounts, defined as an account with less than 3% of the total depreciable plant, can now be filed in a streamlined form.

To put simplification of the depreciation process in the proper context, the needs of the Telephone Companies in a competitive environment should be considered. The NYNEX Telephone Companies are not in a market with just emerging competition;[2] they are in a competitive market. The NYNEX Telephone Companies face vigorous competition from a host of

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2 See NPRM para. 8.

strong, well-financed companies. Technological change and regulatory decisions by both the states and the FCC[3] have created a highly competitive environment in markets which heretofore provided the contribution enabling universal service. While the NTCs have improved efficiency and streamlined service in those areas where they have control, depreciation prescription remains a cumbersome and outdated process going back to the 1940s.[4] The latest Report by Peter Huber, The Geodesic Network II, indicates that the local exchange market is increasingly competitive. The large business, special services and interstate access markets are already competitive. As the contribution to basic local service once generated by these services' customers is sought from other areas, the competition will follow. But these competitors are not constrained to change depreciation rates only at three year intervals, do not have to exhaustively demonstrate that a new technology has affected the life of an old, and are not required to produce volumes of historical data in support of the need for new depreciation rates.

This NPRM seeks to move the depreciation prescription process forward to match the evolution of the

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3 The NTCs' regulators have been very active in pro-competitive dockets that are rendering about 75% of the NTCs' revenues vulnerable to competition: e.g., FCC Dockets 91-141 (interstate special access and switched access), 88-57 (inside wire); NYPSC actions in Case 28425 (intraLATA toll, intrastate switched access), 88-C-004 (intrastate private line), 90-33 (billing and collection), 91-24 (Centrex, PBX), 91-C-1174 (basic business lines and DID), etc. (see infra).

4 See NPRM para. 7.

telecommunications industry. The NYNEX Telephone Companies believe that improvements to the depreciation process must embody simplification, flexibility, timeliness, predictability and consistency.

Effective simplification should mean less paperwork and a significant reduction in the number of account-specific studies and vintage statistical analyses that drive that paperwork. The depreciation prescription filing averages 25 pages per account[5] and represents a substantial labor effort. Many of the class one accounts, which together total 67% of the number of study accounts but account for only 27% of the investment base, have already been streamlined. The major accounts in the depreciation prescription filing, which total the remaining 73% of the investment base, are typically 85-90 pages in length. To make a real dent in the cost of depreciation studies, these major accounts must be simplified.

In the existing depreciation process, depreciation rates do not get prescribed in a timely manner. Excessive reliance is placed on compiling and arranging historical data to overlay historic investment and salvage patterns onto the future in order to determine the depreciation needs of the NTCs. Combining this requirement for historical data with the

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5 See NPRM para. 6. There are a total of 42 depreciable accounts. Depending on the particular circumstances, several of these accounts are broken down into subaccounts for study purposes, and the separate results are composited for an account depreciation rate. For example, the motor vehicles account is analyzed as light and medium trucks, special purpose vehicles, heavy trucks and passenger cars.

three year interval between prescriptions can give rise to a five or six year lag before a depreciation rate is revised in response to a regulatory or competitive action. In addition, a company whose three way meeting occurs in July 1992, for example, would typically receive: an interim booking letter in September 1992; and the official depreciation rate order in January 1993, although the depreciation rate revisions are effective in January 1992. Thus, even if the interim rates are ultimately prescribed, thirteen months will have passed.

Despite the Commission's views about the degree of control Telephone Companies may have over depreciation,[6] there has been a considerable difference between the depreciation rates requested and the rates prescribed. Nonregulated companies that compete for NTC customers have the ability to adjust their depreciation to market conditions in a timely manner. The Telephone Companies lack such ability.

A competitive company must have the flexibility to be able to set depreciation rates in response to market conditions as those conditions occur, as opposed to months or years after the fact.

The FCC's requirement for historical data before changing depreciation rates has produced a distinctly "back-loaded" pattern of recovery in a number of accounts. Such a "catch-up" pattern promotes intergenerational inequities in recovery and can jeopardize full recovery.

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6 See NPRM para. 38.

To correct this pattern, Telephone Companies need the ability to change the depreciation rates and recovery of investments to balance the needs of individual accounts underlying the aggregate book depreciation expense. For example, companies may face a situation in which the overall depreciation expense is appropriate, but market and technology change now require increasing or decreasing individual account rates to properly depreciate and recover investments.

While the NPRM's goals and proposals are very constructive, none of the NPRM's four options in their present form fully resolves all depreciation issues now faced by the Telephone Companies. The FCC may be of the view that the depreciation reserve deficiency problem has been largely resolved. However, the FCC's view of the size of the reserve deficiency (recognized in 1987) was only about one-half of that quantified by the Telephone Companies. It takes more than new methods (i.e., the change from whole life to remaining life methods)[7] to prevent recurrence of a reserve deficiency. If the lives had been correct, whole life methods would not have created a deficiency. Underlying depreciation rates (i.e., depreciation rates without the reserve deficiency amortization) did not improve significantly between 1986 and 1991.

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7 See NPRM para. 31.

B. The Commission's Price Cap Carrier Proposal (Option D) Is The Most Promising Approach To Achieve The Goals Of This Proceeding

The most promising proposal in the NPRM is option D (the price cap carrier option),[8] as applied to all accounts. It is, in terms of paperwork, the simplest proposal. It will allow the Telephone Companies the flexibility to respond to market forces in a timely manner, and will provide for a predictable and consistent recovery of asset investments. This proposal should be introduced either for all accounts immediately upon adoption, or should be phased-in for accounts over a pre-established time period.

Depreciation and capital recovery provide the financial mechanism corresponding to the evolution of technology. Simply put, the recovery of investment in older technology pays for newer technology. In a competitive market, the pace of that investment recovery and technology deployment is critical to the national economy. Gone are the days when regulators and Telephone Companies had some control in transitioning technological change. Option D is the only option that offers the Telephone Companies the ability to effectively apply the depreciation process in today's global competitive environment.

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8 Under this option as written, price cap carriers would file proposed depreciation rates without supporting data, and the Commission would prescribe depreciation after conducting a notice and comment proceeding. See NPRM para. 12.

On its surface option D appears to grant a greater measure of flexibility to Telephone Companies in the depreciation process. However, it should be emphasized that even under option D the primary determinants of depreciation will continue to be factors essentially beyond the control of the carriers, i.e., competition, technological change, customer demand, regulators' initiatives, etc. Moreover, the FCC will still exercise final control in prescribing depreciation rates.[9]

1. The Independent Audit

The depreciation proposals of the Telephone Companies are now overseen by the FCC Depreciation Staff. This oversight gives rise to an assumption of correctness of these rates when we undergo our independent audit, the audit which certifies our annual report. Absent the direct scrutiny of the FCC, our depreciation expense, and the underlying assumption, would be subject to the same scrutiny as a nonregulated company.

Estimates of asset lives should be made without regard to the financial effects of those decisions. In today's competitive environment, a chief determinant of asset lives is the company's plans for modernization in response to market and regulatory forces. The results of and justification for modernization decisions are examined by the independent auditor. In attesting to the reasonableness of depreciation rates, the independent auditor examines consistency with

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9 See NPRM para. 8.

generally accepted accounting principles (GAAP), and whether there has been a systematic and rational approach to determining economic life. Under option D, the auditor would be aware that the FCC no longer engages in protracted examination of those rates.[10] Before so attesting, the rates would be closely scrutinized by the independent auditor.

2. Depreciation Under The LEC Price Cap Plan

Comment is requested by the FCC on whether the sharing mechanism under LEC price cap regulation might influence depreciation decisions.[11] Of course, LECs would like to have a rate of return sufficiently high to enjoy being in the sharing range. To suggest that depreciation expense might be raised to avoid this sharing runs contrary to reasonable business practice. If a LEC, through innovative marketing and efficiency improvements, could reach a level of earnings to engage in sharing, the LEC would not in effect take money from the shareholder to avoid that sharing. Moreover, depreciation accounting must conform to generally accepted accounting principles, as well as withstand audits and regulators' scrutiny.

There are also longer range consequences to raising depreciation rates to higher than appropriate levels. The sharing levels under price caps are based on rate of return calculations, which use net plant (gross plant less

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10 See NPRM n. 10.

11 NPRM para. 40.

depreciation reserve) as a denominator. If a LEC attempted to increase depreciation in a given year to avoid sharing, it would also increase the reserve during that year, reducing the net plant. Other things being equal, the rate of return would be even higher the following year, requiring even higher depreciation rates to avoid sharing, increasing the reserve even more, leading to a vicious circle.

The pace of modernization forms a cycle with depreciation. The faster a Telephone Company modernizes, the faster the old technology will be retired and the faster the investment in that technology must be recovered. This results in additional funds for infrastructure development and the cycle is completed. The FCC's request for comment on depreciation and price cap sharing implies that the Telephone Company might modernize too rapidly. There is a consensus within both government and industry that the development of the nation's telecommunications infrastructure is of overwhelming importance to the nation's future. If the earnings level of a Telephone Company facilitates such modernization policy, this will be a positive situation.

3. The FCC's Depreciation Responsibility

Concern is expressed regarding whether the FCC could be considered to have abdicated its responsibility for depreciation prescription under Section 220(b) of the Communications Act, if option D were implemented.[12] The

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12 See NPRM, Concurring Statement of Commissioner Duggan dated December 10, 1992.

proposal, as written, still requires the FCC to prescribe depreciation rates, and to notify the states and consider their comments. If the lack of documentation for the rates remains a concern among those commenting on this NPRM, the FCC might consider alternatives that would not generate the degree of paperwork burden which this NPRM is designed to eliminate. One alternative would be to include that documentation already required by the independent auditors. Another would be a simple statement of the modernization plans which form the basis of the requested depreciation rates. Still another alternative would be the summary statements of investments, economic lives and salvage which now accompany depreciation filings.[13] Nothing in the Communications Act can conceivably be interpreted to mandate the extremely detailed filings now required.

Such approaches would be consistent with the following precepts: a depreciation prescription proceeding is a rulemaking of particular applicability under the Administrative Procedure Act (APA);[14] nothing in the APA requires the participation of anyone other than the carrier involved in a depreciation prescription proceeding;[15] the FCC's Public Notice need not give every bit of background information nor

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13 See USTA Comments. The price cap carriers could file statements A and B, as they do today, with a justification letter or statement.

14 1990 Depreciation Rates Order released January 31, 1991, 6 FCC Rcd 750, para. 12, citing APA, 5 U.S.C. Section 553(b).

15 1990 Depreciation Rates Order, para. 12.

publish the precise rates that will be ultimately adopted; the Commission should assure at least a meaningful opportunity for parties to be heard, and that its ultimate prescription order be supported by record evidence and not be contrary to law or arbitrary, etc.

A seemingly common misunderstanding of option D is that the FCC would simply abandon its scrutiny of depreciation rates. This is not so. Again, the companies would still file for depreciation changes, and the FCC would examine those filings to determine if the proposed rates were reasonable. The existing notion that extreme precision makes for superior forecasts, and that bulk and a wealth of numbers somehow assure accuracy, would be eliminated. Rates that vary unreasonably from year to year and rates that do not reflect the announced modernization goals could be subjected to additional scrutiny. Indeed, the FCC can always seek additional support for any rate. Adoption of option D would result in a simplified process, and forward looking rates which are consistent, timely and reflective of our increasingly competitive environment.

With respect to the state notification requirement of Section 220(i) of the Communications Act,[16] the NTCs expect and continue to welcome their State commissions' involvement in the depreciation process, even though FCC prescriptions do not preempt the states.[17] The FCC intends, in this proposal, to notify the states via a Public Notice, and to request and

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16 See NPRM para. 42.

17 See Louisiana PSC v. FCC, 476 U.S. 355 (1986).

consider their comments in the depreciation prescription process. This should be sufficient notice under Section 220(i), though the NTCs would not object to additional communications with and involvement of their State commissions.

4. Additional Guidelines

Any other concerns on potential "manipulation" of depreciation expense could be alleviated by simple guidelines which can also serve to solve existing problems with the depreciation process. One suggestion is to limit the changes in depreciation rates to once per year. Another is to provide that depreciation rate changes always be prospective. This would both eliminate any ability to influence a rate of return increased by an unexpectedly good year, and provide predictability of depreciation expense for the company. Along with requiring only prospective changes, the FCC might consider limits for yearly changes. Requiring that the composite rate be maintained within certain limits from year to year would prevent any manipulation and establish consistency and predictability of a company's financial status.

C. Options A And B, Especially B, Could Offer Improvements To The Depreciation Process If Properly Modified

In the form now set forth by the NPRM, options A and B would not be acceptable or realistic means of prescribing

depreciation rates.[18] The proposed method of establishing ranges in those options is deficient. Either an industry-wide (including nonregulated companies) benchmark method or a range based on Telephone Company proposals should be used. Rates proposed by the industry better reflect the future operating environment and offer an appropriate starting point for a new prescription process. These proposals capture the impact the industry will face from competition, regulation, customer demand, technology advancement, etc. Establishing ranges based on either factors or rates that the Telephone Companies now consider inadequate, and then further narrowing those ranges to exclude companies with special circumstances, would be a rigid approach to simplification and could result in incomplete capital recovery.

The ranges need to be wide enough to permit variations for carriers and provide the flexibility to adjust existing rates in a direction that reflects the market. Furthermore, a carrier should have the option to perform a full depreciation study should the range of rates or factors not be appropriate for its operating environment.

Regardless of the FCC's views on the level of competition in the local exchange market, it is clearly the

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18 Option A, the basic factor range option, would establish ranges for the basic factors that determine the parameters used in the depreciation rate formula. NPRM para. 9. Option B, the range of rates option, would establish ranges for depreciation rates. NPRM para. 10. And option C, the depreciation schedule option, would establish a depreciation schedule for each plant account. NPRM para. 11.

goal of both federal and state regulators to make that market competitive. The widening of the market available to competitive access providers, as well as collocation and expanded interconnection are more recent regulatory initiatives. As described further herein, long distance carriers, cellular operators, cable TV companies, new wireless companies and other competitive access providers are aggressively marshalling their strong resources to secure their shares of the local exchange market. Simple cost trends in electronic technology make it evident that, within the short term future, cellular telephone stations will be cost competitive with the existing wireline stations. Both the FCC and the new administration have expressed the need for development of a telecommunications infrastructure capable of far more information transmission than today's infrastructure can provide.

The NTCs face an intensifying competitive environment which underscores the need to initially set proper ranges to permit recovery of investments. The effects of collocation and numerous competitive entry dockets in this dynamic climate must be reflected in this process.

There can be little argument that the period since divestiture has seen a number of strong, technologically astute and well-financed companies enter markets that formerly were the exclusive province of the LECs. These companies have selectively entered and expanded their presence in markets they believe offer the margins necessary to achieve their return requirements. We expect them and others to continue to do so with vigor.

Upon examination, the services either currently being provided or contemplated by our competitors have at least two elements in common -- they all draw their revenue from segments of what was formerly the LEC market, and they are all supported by digital communications network platforms that appear to be positioned for expansion to broadband network applications.

With the exception of AT&T, none of these companies are subject to regulation prescribing the depreciation lives of their equipment.[19]

Moreover, to the extent that they initiated service to customers using up-to-date, state-of-the-art technological platforms, they have obtained market presence free of constraints regarding either the replacement of obsolete technology or the recovery of capital previously expended on such technology.

A number of indicators have emerged that we believe clearly mark the course being taken by our competitors. Not surprisingly, these indicators -- when viewed in light of collocation, the potential of intraLATA presubscription, and FCC actions regarding interstate switched access interconnection and 800 number portability -- point to competitors positioning themselves for further growth and an expanded market presence. For example:

- All states in the NTCs' service area allow competition for intraLATA toll services, with AT&T, MCI and US SPRINT along

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19 AT&T is aggressively seeking FCC authorization to set depreciation rates for regulatory purposes in conformity with those used for financial reporting purposes. See AT&T Petition For Waiver filed January 27, 1993.

with local carriers such as Long Distance North having received authorization as intrastate toll carriers. With their ability to provide services across jurisdictions together with their packaged calling plans, fiber/digital based telecommunications networks and technological expertise, these companies appear poised to provide a host of single point-of-contact services to both business and residence customers.

- Competitive Access Providers (CAPs) such as Teleport and MFS are providing diverse special and switched services such as Point Of Presence (POP) - to - POP access transport, large business to POP transport, private line networks,[20] large business disaster recovery, facilities management services, local area network services, local PBX loop services and terminating long distance calling.

- Teleport and MFS deploy extensive fiber networks in both New York and Boston which provide transport to the concentrated business customers in these urban areas. In New York and Massachusetts, the CAPs now can collocate in Telephone Company buildings, enabling them to utilize the Telephone Company subscriber access facilities and reach locations where they have no facilities of their own.

- In addition to expansion of its fiber network, MFS has announced plans to enter the switched services market and to begin providing services such as Centrex, Disaster Recovery, Direct Outward Dialing and Direct Inward Dialing. To that end, MFS has begun negotiations with switch vendors such as AT&T, Northern Telecom and Fujitsu.

- Not only is Teleport also expanding its fiber network to provide Centrex and PBX tie line services, but it too is planning to market switched services to its customers via AT&T 5ESS switches.

- Originally a fiber-based provider of transport services, WilTel, with its acquisition of Telesphere, has become a switched services carrier using a Northern Telecom switch.

- Cox Enterprises/TCI's recent purchase of Teleport, and IBM/Time Warner's joint effort with two Japanese companies to develop video on demand technology and library storage of movies, provide examples of strong partnering for potential market development.

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20 For example, New York Telephone estimated that in New York State, the CAPs had more than 40% of the High Capacity Special Access market, measured in DS1 equivalent, even without collocation. See NTCs' Reply Comments filed September 20, 1991 in CC Docket No. 91-141, p. 7.

- AT&T is purchasing a third of the largest cellular phone operator in the nation, McCaw Cellular Communications. AT&T Chairman, Robert Allen, is reported to have said the deal "...assures [AT&T] a leading role in the tremendous expansion of wireless services". Indeed, the number of cellular customers is growing exponentially while the price of a cellular set is decreasing exponentially. At some point, cellular service may become an alternative to landline service.

- Dennis Patrick, President of Time Warner Telecommunications and former Chairman of the FCC, describes Time Warner's cable system as a broadband network expected to compete with LECs in delivering voice, data, video and wireless services to both business and residence customers.

It is essential that the NTCs also continue to evolve and position their switching and transport networks to meet customer expectations and competitive challenges. If we do not, our competitors will take an ever larger share of our customer base. Thus, we are faced with a choice -- either we replace our embedded equipment base with an intelligent, integrated wideband digital network, or we will lose our customer base to competitors who do. In either case, the remaining life of our embedded investment is shortened.

Furthermore, with respect to option A, the suggestion that the ranges might only have to be updated every five to ten years[21] contradicts the very reason for the NPRM. Changes in telecommunications technology have fostered increased entry into the industry, and the regulators have responded by promoting competition. The technological evolution shows no sign of abating. While some minor accounts now seem stable (buildings, motor vehicles, poles, conduit), the major accounts

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21 NPRM para. 21.

are the ones that relate to this changing technology. A one year review of some accounts would not be unreasonable.

Overall, both options A and B involve limited simplification. As in the discussion for option D, neither of these proposals will realize measurable savings unless embraced for all accounts. Should option D not be deemed acceptable, the NTCs would support option B, with the modifications suggested above and for all accounts. This proposal would offer increased simplification over option A and, provided that the ranges are appropriate, would allow for competitive flexibility.

D. Option C Is Inappropriate And Should Be Rejected

Option C is not very promising, however, because it would be: backward-looking in relying upon Commission-defined averages; too complex in requiring tracking of accruals by vintage, a monumental task; and less accurate, as the FCC concedes.[22] The use of single number averages (as opposed to ranges) for the prescribed factors assures that the actual experience of most companies will deviate, sometimes sharply, from the resultant depreciation. In short, option C is neither simple nor progressive, and should be discarded.

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22 NPRM para. 33 (Option D "offers the greatest deviation from accuracy in matching allocation of costs with plant consumption").

III. CONCLUSION

The Commission's efforts to simplify and modernize the depreciation prescription process should be commended. For the reasons stated, the NYNEX Telephone Companies support the Commission's price cap carrier option (option D) as striking the best balance in attaining the Commission's goals.

Respectfully submitted,

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CC 92-296

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing COMMENTS OF THE NYNEX TELEPHONE COMPANIES, was served by hand, on each of the parties indicated below, this 10th day of March, 1993.

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